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Supreme Court, U. S.
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IN THE

Supreme Court of the United States

October Term 1979

No. 79-.....

CHARLES G. RODMAN, as Trustee of the Estate of W. T. Grant Company, Bankrupt,

Petitioner,

v.

ALTON RINIER, as Agent for Certain Employees of Bankrupt, ANSWERING EMPLOYEES OF BANKRUPT, LOCAL 807-IBT, RETAIL CLERKS INTERNATIONAL ASSOCIATION, NATIONAL LABOR RELATIONS BOARD,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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* The appendix material in respect of the petition herein and in respect of a petition concurrently filed by Morgan Guaranty Trust Company of New York ("Morgan") is set forth in a separate Joint Appendix filed on behalf of both petitioners Morgan and Charles G. Rodman, as Trustee of the Estate of W. T. Grant Company, Bankrupt. References to the Joint Appendix will be designated "Jt. App."

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner, Charles G. Rodman, as Trustee for the Estate of W. T. Grant Company, Bankrupt, (the "Trustee"), requests the issuance of a writ of certiorari to the United States Court of Appeals for the Second Circuit (the "Second Circuit") to review that court's judgment and decree entered January 3, 1980. The Second Circuit decree affirmed an order of the United States District Court for the Southern District of New York (the "District Court") that had affirmed an order of the bankruptcy court for that District. The bankruptcy court had determined that thousands of employee claims for severance pay benefits earned substantially prior to the commencement of a bankruptcy case constituted costs and expenses of administration in their entirety, entitled to a first priority of distribution under Section 64a(1) of the Bankruptcy Act, 11 U.S.C. § 104a(1) (the "Act"). The decisions below were rendered (a) despite contrary decisions by other United States Courts of Appeals that had considered the

issue,* and (b) without any consideration as to the extent of any benefits that were received by the bankrupt estate from any work, labor or services performed by an employee and paid for by Grant after the filing of the petition under the Act.

Opinions Below

The judgment and decree of the Second Circuit, dated January 3, 1980, is not officially reported and appears in Jt. App. I annexed hereto. The decision and order of the District Court, dated July 18, 1979, is officially reported at 474 F. Supp. 788, and a copy thereof is annexed hereto as Jt. App. II. The order of the bankruptcy court, July 21, 1978, based upon its decision dated June 22, 1978, is not officially reported and both the order and the decision appear in Jt. App. III annexed hereto.

Jurisdiction

The judgment and decree of the Second Circuit was entered on January 3, 1980, and this petition for certiorari was filed within 90 days of that date. The jurisdiction of the Court is invoked pursuant to 28 U.S.C. § 1254(1) and Section 24c of the Bankruptcy Act, 11 U.S.C. § 47c.

Questions Presented

1. Are claims for severance pay benefits earned as part of wages prior to the filing of a bankruptcy petition entitled to 100% payment as costs and expenses of administration of the bankrupt's unsuccessful Chapter XI case irrespective of (a) the period of employment of the claimant after the filing of the petition; (b) the absence of any authorized or intended assumption by the bankruptcy fiduciary of the bankrupt's

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* *In re Mammoth Mart, Inc.*, 536 F.2d 950 (1st Cir. 1976); *In re Public Ledger, Inc.*, 161 F.2d 762 (3d Cir. 1947). Since the order of the Second Circuit was entered, the United States Court of Appeals for the Ninth Circuit has rendered a decision which also is in conflict with the Second Circuit and the subject judgment and decree. *Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc.*, . . . F.2d . . . (9th Cir. 1980), is not yet officially reported and a copy is annexed as Jt. App. IV.

pre-bankruptcy severance pay policies or agreements; (c) the provisions of Section 64a of the Act, 11 U.S.C. § 104a, which establish the hierarchy of priority claims including wages against a bankrupt estate, and (d) the rejection of the pre-bankruptcy executory policies and agreements pursuant to Sections 378(2) and 70b of the Act, 11 U.S.C. §§ 778(2) and 110b, retroactive to the date of the filing of the bankruptcy petition?

2. Does the failure of a bankruptcy fiduciary, i.e., a debtor-in-possession or trustee, to reject formally executory policies and agreements pursuant to the provisions of the Act result in the automatic assumption of such policies and agreements as administrative costs of the bankrupt estate?

3. In the absence of an authorized assumption of pre-bankruptcy executory severance pay policies and agreements by a bankruptcy fiduciary, is a claimant who performs pursuant to such policies or agreements entitled to receive more than the reasonable value of the benefits conferred upon the bankrupt estate as a result of the claimant's performance?

Statutes Involved

Section 64a(1) and (2) of the Act, 11 U.S.C. § 104a(1) and (2):

Section 64. **Debts Which Have Priority.**

> a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; * * * (2) wages and commissions, not to exceed $600 to each claimant, which have been earned within three monthsbefore the date of the commencement of the proceeding, * * *

Section 378(2) of the Act, 11 U.S.C. § 778(2):

Section 378. Upon the entry of an order directing that bankruptcy be proceeded with

* * *

(2) in the case of a petition filed under Section 322 of this Act [an original petition under Chapter XI of the Act], the proceeding shall be conducted, so far as possible, in the same manner and with like effect as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under this chapter [XI] was filed; and the trustee nominated by creditors under this chapter shall be appointed by the court, or, if not so nominated or if the trustee so nominated fails to qualify within five days after notice to him of the entry of such order, a trustee shall be appointed by the court;

Section 70b of the Act, 11 U.S.C. § 110b:

b. The trustee shall assume or reject an executory contract, including an unexpired lease of real property, within sixty days after the adjudication or within thirty days after the qualification of the trustee, whichever is later, but the court may for cause shown extend or reduce the time. Any such contract or lease not assumed or rejected within that time shall be deemed to be rejected.***

Statement of the Case*

On October 2, 1975, W. T. Grant Company ("Grant") filed a petition for an arrangement under Chapter XI of the Act. Prior thereto Grant was engaged in the business of operating and managing a nationwide chain of approximately 1,070 retail outlets for the sale of general lines of merchandise. As part of its pre-bankruptcy employment policies and practices, relating to substantially all of its employees, and collective

* The facts stated are distilled from the opinions of the lower courts and those set forth are undisputed.

bargaining agreements as to a small minority of its employees, Grant offered to its employees a wage and compensation package that included severance pay benefits. The severance pay benefits were earned by each employee based upon his or her length of employment.* Thus, the dollar amount of severance pay benefits which were earned was a direct function of the employee's service period.

Subsequent to the filing of the Chapter XI petition, Grant, as a debtor-in-possession under Section 342 of the Act, 11 U.S.C. § 742,** informed its employees and gave notice to all store managers of the suspension of the payment of severance pay benefits during the pendency of the Chapter XI case subject to further order of the bankruptcy court.

The Chapter XI case extended from October 2, 1975 to April 13, 1976, the date that Grant was adjudged a bankrupt under the Act. Prior to the date of adjudication and almost immediately subsequent to the filing of the Chapter XI petition, Grant embarked upon a contraction of the number of its operating retail outlets. By the end of December, 1975, over 400 retail stores had been closed. In February, 1976, it became apparent that the rehabilitation attempt under Chapter XI of the Act would be unsuccessful and, by order of the bankruptcy court dated February 12, 1976, Grant was directed to terminate and liquidate all of its retail operations. Consequently as of April 13, 1976, essentially all of the retail outlets had been closed and liquidated.

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* The severance pay benefits policies of Grant in effect prior to October 2, 1975, are set forth in the Grant Store Manual, District Manager's Guide to Termination Policy and Procedures, New York Office Supervisor's Personnel Manual and approximately 53 collective bargaining agreements.

** A debtor-in-possession is a bankruptcy fiduciary. Where no receiver is appointed the debtor-in-possession has all the title and exercises all of the powers of a trustee undert the Act. Section 342 of the Act, 11 U.S.C. § 742; see also, *In re Wil-Low Cafeterias, Inc.*, 111 F.2d 83 (2d Cir. 1940); *In re Walker*, 93 F.2d 281 (2d Cir. 1937) 8 Collier, *Bankruptcy* ¶ 6.32[2] at 931-32 (14th ed. 1978).

Throughout the pendency of the Chapter XI case, Grant, as a debtor-in-possession, paid no severance pay benefits to terminated employees with the exception of a single payment made to a former executive pursuant to a specific order of the bankruptcy court approving the same. The bankruptcy court neither authorized nor approved any assumption of the executory pre-bankruptcy severance pay policies and agreements of Grant by the debtor-in-possession during the Chapter XI case. No application was made by the debtor-in-possession for authority to assume such executory policies and agreements until April 8, 1976, just five (5) days before the date that was known to all parties in interest to be the date that Grant would be adjudged a bankrupt. The hearing date for the application had been set for a date fourteen (14) days subsequent to the date of adjudication. The Trustee did not adopt the application and it lapsed.

In accordance with the Act, January 14, 1977 was the last date for the filing of proofs of claim against the bankrupt estate. As of the close of business on that date, former employees of Grant had filed a total of 49,344 proofs of claim. Proofs of claims for severance pay benefits totalled 41,187 seeking an aggregate recovery of approximately $20,000,000. After review of such proofs of claim, the Trustee determined, after eliminating duplicate claims, that approximately 28,000 claims for severance pay benefits remained. The Trustee estimated that the proofs of claim for severance pay benefits might ultimately aggregate $11,382,000.

By application to the bankruptcy court dated May 10, 1977, the Trustee sought instructions as to the disposition of the claims for severance pay benefits. Inasmuch as Grant's pre-bankruptcy wage and compensation policies had provided for the earning of severance pay benefits based upon length of employment, the Trustee proposed that (a) the portion of a discharged employee's severance benefits claim earned subsequent to the commencement of the Chapter XI case and prior to the date of the employee's termination be paid in full, as a cost and expense of administration under

Section 64a(1) of the Act, *supra*; (b) the portion of such claim earned during the three (3) months prior to the commencement of the Chapter XI case be paid as a second priority under Section 64(2) of the Act, *supra*; and (c) the remaining portion of such claim, i.e., earned more than three (3) months prior to the filing date and not a priority claim under Section 64a(2) of the Act, *supra*, be treated as a pre-bankruptcy general unsecured claim. The Trustee also proposed that, for the purpose of determining what portion of an employee's claim was to be accorded priority status, each employee's total severance pay be allocated over a twelve-month period so as to avoid inequity and prejudice to long-term employees.

The Trustee submitted that the pre-bankruptcy executory wage and employment policies and agreements of Grant had not been assumed by the debtor-in-possession. Therefore, the severance pay benefits did not constitute a Section 64a(1) cost and expense of administration entitled to full payment as distinguished from other components of wages earned pre- and post-bankruptcy that are subject to the statutory limitations and allocations as provided by Section 64a(2) of the Act, *supra*. The Respondents objected to the Trustee's proposal and claimed that all severance pay benefits constituted administrative expenses entitled to full payment.

After hearing, the bankruptcy court rendered its decision dated June 22, 1978. Although the bankruptcy court recognized the inequities and illogical consequences resulting therefrom and the conflicting decisions in the First and Third Circuits,* it concluded that as an inferior court it was bound by the Second Circuit decision of *Straus-Duparquet, Inc.* v. *Local Union No. 3, IBEW*, 386 F.2d 649 (2 Cir. 1967). The bankruptcy court determined that all severance pay benefits constituted costs and expenses of administration irrespective of when earned and the limitation as to the amount of a priority wage claim under Section 64a(2) of the Act, *supra*. The District Court affirmed the order of the bankruptcy court

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* See footnote at page 2, *supra*.

on the basis of *Straus-Duparquet* and further upon the ground that, irrespective of *Straus-Duparquet*, the debtor-in-possession's failure to reject formally the pre-bankruptcy executory policies and agreements of Grant as to severance pay benefits resulted in the *automatic* assumption of such executory obligations by the debtor-in-possession and the bankrupt estate.

The Second Circuit affirmed the District Court. It concluded that Grant as a debtor-in-possession, as a matter of law, had assumed the pre-bankruptcy executory policies and agreements of the bankrupt as to severance pay benefits, *In re Unishops, Inc.*, 553 F.2d 305 (2d Cir. 1977), and, in any event, severance pay benefits were compensation for termination, "* * * as opposed to a form of wages * * *," entitled to the status of a cost and expense of administration, *Straus-Duparquet, supra.*

REASONS FOR GRANTING THE WRIT

I

The Decision Below is in Conflict With Decisions of Other Courts of Appeals.

Two basic issues were presented to the Second Circuit. First, in reaching its decision that severance pay benefits earned on the basis of years of service are not allocable in the same manner as wages under the Act, the Second Circuit rejected the decisions of *In re Mammoth Mart, Inc.*, 536 F.2d 950 (1st Cir. 1976) and *In re Public Ledger, Inc.*, 161 F. 2d 762 (3d Cir. 1947). In *Mammoth Mart* and *Public Ledger*, each Court of Appeals decided that severance pay benefits earned as part of wages must be allocated in the same manner as wages under Section 64a of the Act, *supra.* The Trustee's proposal as to the disposition of claims for severance pay benefits conforms with the principles enunciated in *Mammoth Mart* and *Public Ledger.*

Secondly, in determining that by inaction the debtor-in-possession had assumed the bankrupt's executory policies and agreements irrespective of the benefits received, the

Second Circuit also rejected the long established principle of bankruptcy jurisprudence that the assumption of executory contracts which results in the creation of first priority costs and expenses of administration under Section 64a(1) of the Act, *supra*, requires an express order of the bankruptcy court. *In re Gulfco Investment Corp.*, 520 F.2d 741 (10th Cir. 1975); *In re Maryvale Community Hospital, Inc.*, 456 F.2d 414 (9th Cir.), *cert. denied*, 409 U.S. 879 (1972); *In re American National Trust*, 426 F.2d 1059 (7th Cir. 1970); *Texas Importing Co.* v. *Banco Popular de Puerto Rico*, 360 F.2d 582 (5th Cir. 1966); see also, 6 *Collier*, Bankruptcy, ¶ 3.23[5] at 578 (14th ed. 1976). Since the judgment and decree of the Second Circuit, the conflict between the circuits as to the rejection or assumption of executory contracts by inaction or acceptance of benefits has been heightened by the decision of the United States Court of Appeals for the Ninth Circuit in *Local Joint Executive Board AFL-CIO*, v. *Hotel Circle, Inc.*, F.2d (9th Cir. 1980) (Jt. App. IV).

The Ninth Circuit held that even though a receiver had operated the debtor's business in accordance with the provisions of a pre-bankruptcy executory collective bargaining agreement and had participated in negotiation relating thereto, in the absence of assumption with court approval neither the receiver nor the estate was bound by the executory provisions. In contrast, the Second Circuit has held that a bankruptcy fiduciary, i.e., a debtor-in-possession or trustee, may through inadvertence or mere inaction and without notice to affected parties assume executory contracts and policies, resulting in the creation of what may be substantial costs and expenses. Such costs and expenses of administration may be of a magnitude sufficient to preclude the payment and satisfaction of any inferior priority claims as well as the claims of general unsecured creditors.

Thus, the instant petition pertains to matters of importance in the administration of debtors' estates under federal bankruptcy laws. If the Second Circuit decision is

allowed to stand with its extension of the so-called *Straus-Duparquet* doctrine, the basic principle of bankruptcy jurisprudence, i.e., equality of distribution to creditors of the same class, will be significantly impaired without legislative authority therefor. *Nathanson* v. *National Labor Relations Board*, 344 U.S. 25 (1952). The administration and distribution of assets of debtor's estates will be different depending upon the judicial circuit within which the debtor's case is pending.* Thus, satisfaction of claims of employees based upon similar grounds will vary substantially from one judicial district to another depending entirely upon the irrelevant fact of geography.

The enactment of the Bankruptcy Reform Act of 1978, Public Law No. 95-598, 92 Stat. 2549 (1978) (the "Bankruptcy Code"), does not moot the instant petition. Unless the law is clarified as to the disposition and treatment of claims for severance pay benefits and as to the prerequisites for the assumption or rejection of executory contracts and policies, the application of the limitations imposed upon claims for severance pay benefits as provided in the Bankruptcy Code, Section 507(a)(3) of Title 11 U.S.C. (1979), will be dependent entirely upon the vagaries of the respective judicial circuits. Further, the construction of the provisions of Section 365 of the Bankruptcy Code, 11 U.S.C. § 365 (Executory contracts and unexpired leases), may be adversely affected by the Second Circuit's decision as to the manner in which executory contracts may be assumed by a fiduciary in a debtor's case.

The Bankruptcy Code carries forward the first priority position of costs and expenses of administration. Therefore, the Second Circuit decision will continue to have vitality and

* The 1978 Annual Report of the Director of the Administrative Office of the United States Courts reflects that 202,122 petitions under the Act were filed that year. Every bankruptcy petition involves questions relating to executory contracts and policies. Chapter XI filings increased from 1969 by 7.2%. It is anticipated that current economic conditions may result in a significant number of filings under the Bankruptcy Code.

result in disparate treatment of claims for "tenured" severance pay benefits as well as the establishment of undefined standards for the assumption or rejection of executory contracts. Each of the subject matters dealt with by the Second Circuit decision represent critical aspects of bankruptcy administration, particularly in these difficult economic times. Clarification by the Supreme Court is essential. Accordingly, a writ of certiorari should issue.

II

Pre-Bankruptcy Severance Pay Policies and Agreements do not Result in Bankruptcy Administration Claims Unless Assumed by the Bankruptcy Fiduciary.

Pre-bankruptcy executory obligations of a debtor do not result in first priority costs and expenses of administration under the Act unless the bankruptcy fiduciary, e.g., debtor-in-possession or trustee, assumes such executory obligations and thereby obligates the debtor's estate for the payment of the same as administrative expenses. The mere fact that a liability to pay matures after the commencement of a bankruptcy case does not make that liability an administrative claim unless assumed by the bankruptcy fiduciary. Thus, severance pay benefit claims earned during employment are no different than a claim for goods sold and delivered prior to the filing of a bankruptcy petition the payment for which matures thereafter. *In re Godwin Bevers Co., Inc.*, 575 F.2d 805 (10th Cir. 1978); *Denton & Anderson Co.* v. *Induction Heating Corp.*, 178 F.2d 841 (2d Cir. 1949). Indeed, the continued use of leased premises by a bankrupt fiduciary with payment for such use and occupancy does not result in all lease payments and obligations becoming costs and expenses of administration. *Sunflower Oil Co.* v. *Wilson*, 142 U.S. 313 (1892); *In re J. Bain, Inc.*, 554 F.2d 255 (5th Cir. 1977); *In re Fredrick Meats, Inc.*, 483 F.2d 951 (9th Cir. 1973); *Bank of America National Trust and Savings Ass'n.* v. *Smith*, 336 F.2d 528 (9th Cir. 1964); *American Anthracite & Bituminous Coal Corp.* v. *Leonardo*

Arrivabene, S.A., 280 F.2d 119 (2d Cir. 1960); 4A Collier, *Bankruptcy* ¶ 70.44[4] at 550-52 (14th ed. 1976).

Further, a debtor-in-possession is a separate and distinct juridical entity. Thus, in *Shopmen's Local Union No. 455*, v. *Kevin Steel Products, Inc.*, 519 F.2d 698 (2d Cir. 1975), the established principle of law was stated as follows:

> The argument [of the union as to the binding effect of a collective bargaining agreement on the debtor-in-possession] fails to take into account the nature of a bankruptcy proceeding. A debtor-in-possession under Chapter XI or under Chapter X, a trustee under the latter chapter, or a trustee in a straight bankruptcy proceeding is *not* the same entity as the pre-bankruptcy company. A new entity is created with its own rights and duties, subject to the supervision of the bankruptcy court.

519 F.2d at 704. (Emphasis by court). See also *Brotherhood of Railway* v. *REA Express, Inc.*, 523 F.2d 164 (2d Cir. 1975), *cert. denied*, 423 U.S. 1017, 1073 (1976); *Allegaert* v. *Perot*, 548 F.2d 432 (2d Cir. 1977).

Accordingly, a debtor-in-possession, as a separate legal entity, is not bound by the provisions and obligations of a debtor's pre-bankruptcy executory policies and contracts. Rather, such executory contracts and policies are suspended pending the decision as to whether the same should be assumed or adopted in accordance with the provisions of the Act. *Truck Drivers Local Union No. 807* v. *Bohack Corp.*, 541 F.2d 312 (2d Cir. 1976).

In a Chapter XI case, an executory contract of a debtor may be rejected pursuant to Section 313(1) of the Act, 11 U.S.C. § 713(1), or as part of a Chapter XI plan in accordance with Section 357(2) of the Act, 11 U.S.C. § 757(2). The latter provision is meaningless unless a decision as to rejection, which is antithetical to assumption, can await the promulgation, acceptance and confirmation of a Chapter XI plan. The confirmation of a Chapter XI plan providing for the rejection

of an executory contract or such rejection pursuant to Section 313(1), *supra*, results in the relation-back of the effective date of rejection to the date of the filing of the Chapter XI petition.

Nonetheless, the Second Circuit decided that since the debtor-in-possession did not formally reject the bankrupt's pre-bankruptcy executory policies and agreements as to severance pay benefits, it assumed the bankrupt's obligations thereunder. The Second Circuit's decision is erroneous in at least two respects. First, the debtor-in-possession did not take any affirmative action and the record is devoid of any evidence establishing the assumption by the debtor-in-possession of the pre-bankruptcy executory policies and agreements concerning severance pay benefits. Indeed, the record establishes the converse as to the intent of the debtor-in-possession. As noted in the decision of the District Court, Grant, as a debtor-in-possession, specifically alerted and apprised its employees that severance pay benefits provided for by the bankrupt prior to the commencement of the Chapter XI case would not be paid unless authority were obtained from the bankruptcy court (Jt. App. II). As discussed above, the debtor-in-possession's recognition of the necessity to obtain such court approval is evidenced by its filing of an application with bankruptcy court during the waning days of the Chapter XI case seeking authority to pay severance pay benefits. That application, which was made without consulting with the creditors affected thereby and only after it was determined that the Chapter XI case had failed, was never granted. Thus, no such authority was ever obtained from the bankruptcy court during the Chapter XI case as to the Respondents.

Secondly, the Second Circuit failed to take into account the rejection of the executory policies and agreements in accordance with the specific provisions of the Act. In contrast to the other cases which have considered the priority status of claims for severance pay benefits, *supra*, the Chapter XI Case initiated by Grant failed. Consequently,

the claim status to be accorded to such claims materially affects the potential realization of other creditors from the bankrupt estate. Therefore, the provisions of the Act must be examined carefully.

The Act specifically provides for the consequences resulting from the termination of a Chapter XI case by an adjudication in bankruptcy. Section 378(2) of the Act, *supra*, provides in substance that in a case such as the Grant case, if an order is entered directing that bankruptcy be proceeded with then, "so far as possible," the proceeding shall be conducted "* * * in the same manner and with like effect as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under [Chapter XI] was filed; * * *." An order adjudging Grant a bankrupt and directing that bankruptcy be proceeded with was entered in respect of the Grant case on April 13, 1976. Pursuant to Section 378(2), *supra*, the ordinary or liquidating bankruptcy case relates back ot October 2, 1975, the date of the filing of the Chapter XI petition.

In accordance with the foregoing, Section 70b of the Act, *supra*, became operative. That section provides, in part:

> The trustee shall assume or reject an executory contract, ***, within sixty days after the adjudication or within thirty days after the qualification of the trustee, whichever is later, but the court may for cause shown extend or reduce the time. Any such contract or lease not assumed or rejected within that time shall be deemed to be rejected.

The Trustee qualified on April 13, 1976. Grant was adjudged a bankrupt under the Act on April 13, 1976. The Trustee never assumed the pre-bankruptcy executory policies and agreements of Grant as to severance pay benefits. *A fortiori*, the pre-bankruptcy executory policies and agreements of Grant were rejected effective as of October 2, 1975,

the date of the commencement of the bankruptcy proceedings. Consequently the Second Circuit was wrong in concluding that the pre-bankruptcy executory policies and agreements were never rejected.

III

Assumption of Pre-Bankruptcy Executory Policies and Agreements Requires Explicit Prior Bankruptcy Court Approval.

The necessity of assumption of pre-bankruptcy executory policies and agreements as to severance pay benefits in order to raise claims therefor to a cost and expense of administration is aptly set forth in *American Anthracite & Bituminous Coal Corp.* v. *Leonardo Arrivabene, S.A.*, 280 F.2d 119 (2d Cir. 1960). In that case the court affirmed the denial of claims of certain creditors to be costs and expenses of a Chapter XI administration. The court stated:

> The right to priority in Chapter XI proceedings is governed solely by § 64 of the Bankruptcy Act. See § 302, 11 U.S.C.A. § 702; 8 Collier on Bankruptcy Para. 5.33 (14th Ed. 1941). Section 64, sub. a(1) includes among those claims entitled to first priority "the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition" and "the costs and expenses of administration." *The claim of a creditor having an executory contract with the debtor at the time the debtor's petition is filed is entitled to priority under these provisions only if the trustee or debtor in possession elects to assume the contract or if he receives benefits under it. The right to priority in the event the contract is assumed follows from the fact that the trustee or debtor in possession has elected to make the contract of the debtor his own, just as if it had been made by the trustee or debtor in possession in the first instance. The right to priority in the event the trustee or debtor in possession receives benefits under the contract during the interval between the filing of the debtor's petition and the rejection of the contract "is an equitable right based upon*

> *the reasonable value" of the benefits conferred, rather than upon the contract price.* In re United Cigar Stores Co., 2 Cir., 69 F.2d 513, 515, certiorari denied sub nom. Reisenwebers, Inc. v. Irving Trust Co., 1934, 293 U.S. 566, 55 S.Ct. 76, 79 L.Ed. 665; see Oscar Heineman Corp. v. Nat Levy & Co., 2 Cir., 1925, 6 F.2d 970, 43 A.L.R. 727; Gardner v. Gleason, 1 Cir., 1919, 259 F. 755. *Where no benefits are received by the bankrupt estate or its representative under the contract, and the contract is not assumed, the creditor's claim is not entitled to priority,* Petition of Colburn, 1 Cir., 1926, 16 F.2d 780; In re No Care Elec. Radiator Corp., D.C.S.D.N.Y.1933, 3 F.Supp. 331, although of course, upon rejection, the creditor may file a general claim against the estate. See §§ 63, sub.a(9), 353, 11 U.S.C.A. §§ 103, sub.a(9), 753.

280 F.2d at 124-25. (Emphasis added).

The necessity for court scrutiny and approval before assumption of an executory agreement may become effective was succinctly stated by the Ninth Circuit in the *Hotel Circle* case, *supra*:

> While neither we nor the Supreme Court has passed on the question before us, the more persuasive cases from other jurisdictions hold that " *'assumption or adoption of the contract can only be effectuated through an express order of the [bankruptcy] judge.'* " [citations omitted] The basic reasoning for this view is expressed by Collier:
>
> > The general rule that economy of administration calls for close, strict, and active control by the court of all administrative expenditure seems to lead to the conclusion that it is improper for a trustee to assume executory contracts on his own responsibility.
>
> 4A Collier on Bankruptcy ¶ 70.43[5], at 531 (14 ed. 1976). Similarly, we have expressed the view that "[i]t is well

> settled bankruptcy law that on important decisions, whatever their character, the trustee must get the court's approval * * *." [citations omitted]

Surely, the assumption of executory pre-bankruptcy severance pay policies and agreements of Grant must be characterized as an "important decision." The consequences of such a decision involved the priority claim status of millions of dollars of claims as costs of administration to be satisfied ahead of the claims of other creditors and in excess of the salaries, wages and bonuses that Grant, as debtor-in-possession, paid to its Chapter XI employees for their services. Clearly, an important decision in any bankruptcy case. The standards to apply will have monumental importance in the future administration of bankruptcy cases. The construction of the provisions of the Bankruptcy Code in many instances will be predicated upon pre-Code law. The instant case is of a paramount importance in the future treatment of executory agreements in debtor cases.

The Second Circuit decision allows the assumption of potentially large liabilities and other obligations by silence and without notice to the bankruptcy court or the parties affected thereby—the creditors. Indeed, the Second Circuit found assumption by the debtor-in-possession even though it manifested an intent contrary to assumption. Clearly an incongruous result. To avoid the result mandated by the Second Circuit requires that debtors reject collective bargaining agreements and policies immediately upon the filing of a reorganization petition under the Bankruptcy Code. This type of precipitous action will cause dislocation and labor unrest and potentially will preclude any opportunity for rehabilitation and reorganization of the debtor. The Second Circuit's requirement is incongruous with the provisions of the Act and the Bankruptcy Code which allow for an extended period to consider the consequences of assumption or rejection as well as Congressional policy favoring reorganization.

IV

The Treatment of any Portion of Severance Pay Benefits as Administrative Expenses Must be Predicated Upon Benefits Conferred Upon the Debtor's Estate.

Clarification of the standards to be applied in respect of claims for severance pay benefits absent assumption of the pre-bankrupt's policies and agreements by a debtor-in-possession is essential to future administration of cases under the Bankruptcy Code. The extent of uncompensated benefits received by the bankrupt estate is the only basis upon which claims for severance pay benefits may be entitled to priority as costs and expenses of administration. Compensation as a cost and expense of administration limited to benefits conferred upon a debtor's estate is consistent with the rationale expressed in *American Anthracite, supra.*

The principle expressed in *American Anthracite* is particularly applicable in cases in which severance pay benefits are a component of wages as in the case at bar. In that context, the principle stated in *In re Mammoth Mart, Inc.*, 536 F.2d 950 (1st Cir. 1976) governs. In that decision, the First Circuit noted that the primary purpose of granting administration status to claims arising after the commencement of a case under the Act is to implement "the statutory objective of facilitating the rehabilitation of insolvent businesses." 536 F.2d at 954. Congress presumed that such an objective could be achieved by allowing to those parties providing the necessary goods and services during the course of the administration of a debtor's estate a priority for expenses actually incurred in order to maintain, preserve or rehabilitate the estate. Thus, whether a claim in its entirety is to be characterized as an expense of administration under Section 64a(1) is dependent upon whether "the debt [arose] from a transaction *with the debtor-in-possession.*"

Id.

> *[W]hether a claim for severance pay based upon an unrejected contract with the debtor and arising from a chapter XI discharge will be entitled to § 64(a)(1) priority will depend upon the extent to which the consideration supporting the claim was supplied during the reorganization. . . .*

Id. at 955.

In applying this criteria to the severance pay benefits claims of the debtor's discharged employees, the court concluded that such consideration was lacking:

> Because the amount of severance pay claims *depends upon the length of employment, the consideration supporting appellants' claims was the services performed for Mammoth Mart over the entire period of each appellant's employment. Since no part of their present claims arise [sic] from services performed for the debtor-in-possession, no portion of appellant's claims may receive § 64(a)(1) priority.*
>
> * * *
>
> It is established that a debt is not entitled to priority as a cost and expense of administration simply because the claimants' right to payment arises after the debtor-in-possession has taken some action.
>
> * * *
>
> *The claims for additional severance pay are based entirely upon services performed by appellants to the debtor and, as such, are not entitled to priority.*

Id. (emphasis added) (citations omitted).

Similarly, in *In re Public Ledger, Inc., supra,* the Third Circuit held that when claims for severance pay benefits were based upon collective bargaining agreements that conditioned the amount of such benefits upon length of employment, the benefits were earned on an accrual basis and

constituted wages subject to the provisions of Section 64a(2) of the Act, *supra*. The Court of Appeals in that case found significant the distinction between the concept of when severance pay is "earned" and when it is "due and payable." Since the extent of liability for severance pay was not predicated on the actual termination of the employee, but rather upon his *prior service* with the debtor as in the case of Grant, the Court of Appeals held that the entire claim was not an expense of administration under Section 64a(1):

> We hold that the discharge provision of the [union] contract relates to wages and any sum received by the employee under it is a part of his wage. *Upon the conditions of the contract being met, money earned each day of the service matures in time to the status of a due debt.* Each claim, therefore, should be allowed in its rightful sum as a charge against the estate and that portion which was so earned under the trustees' management should be given the priority due to administrative expense. The same principle should be applied under § 64, sub. a(2) of the Bankruptcy Act, the provision for priority of wages.

161 F.2d at 773 (Emphasis supplied). *See also, In re Diamond REO Trucks, Inc.*, 20 Collier Bankr. Cases 1130 (W.D. Mich. 1979).

Each year thousands of reorganization cases are filed under the federal bankruptcy law. The failure to grant the instant petition will allow the existence of uncertainty and inconsistent results as to the treatment of executory policies and contracts and the material consequences flowing therefrom, particularly with respect to awesome dollar impact of severance pay claims. The continued viability of the Second Circuit decision will substantially reduce the possibilities of reorganization under the Bankruptcy Code. Clarification of the conflicting Circuit Court decisions is essential to the proper functioning of the bankruptcy law.

Conclusion

A writ of certiorari should issue to review the judgment and decree of the Second Circuit.

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Respectfully,

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